

Message Text

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E.O. 11652: GDS

TAGS: EFIN, PE

SUBJECT: PERU'S IMF STANDBY

1. ON A STRICTLY CONFIDENTIAL BASIS WALTER ROBICHEK, DIRECTOR OF THE IMF'S WESTERN HEMISPHERE DIVISION, AND HIS STAFF BRIEFED OFFICERS FROM STATE AND TREASURY ON THE NEW IMF STANDBY ARRANGEMENT WITH PERU WHICH SHOULD BE APPROVED BY THE IMF BOARD BY MID-SEPTEMBER. THE STANDBY ARRANGEMENT WILL RUN THROUGH 1980 AND WILL PROVIDE 24 MILLION SDR'S IN 1978 AND 80 MILLION SDR'S IN BOTH 1979 AND 1980. IMF DESCRIPTION OF THE PROGRAM'S RATIONALE, AND OF SOME OF THE PRESCRIBED POLICY POLICY MEASURES FOLLOWS.

2. BASED ON THE FUND'S ASSESSMENT THAT PERU'S ECONOMIC DIFFICULTIES ARE A CLASSIC CASE OF DEMAND MISMANAGEMENT, THE NEW IMF PROGRAM IS VERY DEMAND-ORIENTED, FOCUSING ESPECIALLY ON IMPROVEMENT IN PUBLIC FINANCES. THE CONFIDENTIAL

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ECONOMIC MEASURES ADOPTED LAST MAY HAVE HAD AND WILL CONTINUE TO HAVE A VERY SUBSTANTIAL IMPACT IN IMPROVING THE FISCAL ACCOUNTS, BUT ADDITIONAL FISCAL MEASURES

ARE REQUIRED TO DECREASE MARGINALLY FISCAL DEFICITS THIS YEAR AND TO DECREASE THEM FURTHER IN 1979. BASED ON A PERCEPTION THAT THE TAX COLLECTION MACHINERY IN PERU HAS VIRTUALLY COLLAPSED, MOST OF FISCAL IMPROVEMENT HAS TO TAKE PLACE ON THE EXPENDITURE SIDE, AND IN THE PRICING POLICIES OF STATE ENTERPRISES. THERE WAS

REPORTEDLY NO GOP RESISTANCE TO IMF'S SUGGESTIONS FOR CUTBACKS IN DOMESTIC MILITARY EXPENDITURES, AND MILITARY FOREIGN EXCHANGE OUTLAYS ARE AUTOMATICALLY DRYING UP AS THE PIPELINE OF IMPORTED MILITARY SUPPLIES COMES TO AN END. FOLLOWING ANOTHER SCHEDULED INCREASE IN THE COST OF GASOLINE IN OCTOBER, THERE WILL BE VIRTUALLY NO SUBSIDIES LEFT IN PERU, AND PUBLIC ENTERPRISES AS A WHOLE SHOULD BE OPERATING WITH ONLY A SLIGHT DEFICIT BY THE END OF 1978, AND ARE EXPECTED TO REGISTER SLIGHT POSITIVE SAVINGS IN 1979. MUCH OF THE GOVERNMENT EXPENDITURE SAVINGS ARE TO COME FROM A MASSIVE CUTBACK IN PUBLIC SECTOR EMPLOYMENT. PUBLIC SECTOR ENTERPRISES ARE REQUIRED TO CUT 20,000 FROM THEIR PAYROLLS AND THE CENTRAL GOVERNMENT 10,000. OBVIOUSLY WAGE POLICY WILL ALSO BE AN IMPORTANT PART OF THE PROGRAM. MODERATE NOMINAL INCREASES ARE BUILT IN; THERE WILL BE AN 8-10 PERCENT INCREASE IN 1978 AND TWO SUCH INCREASES IN 1979. WITH ALL CUTBACKS IN SUBSIDIES NOW ACCOMPLISHED, THE PROGRAM DOES NOT IMPLY A RISE IN THE REAL PRICE OF ANY GOODS. HOWEVER, THE GOP HAS AGREED THAT PRICES WILL BE FREQUENTLY ADJUSTED TO KEEP PACE WITH COSTS. AS A WHOLE, THESE MEASURES ARE DESIGNED TO REDUCE THE PUBLIC SECTOR DEFICIT TO 2 PERCENT OF GDP BY THE CONFIDENTIAL

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END OF 1979.

3. THE SPECIFIC COMPLIANCE TARGETS WITHIN THE PROGRAM INCLUDE 1) LIMITS ON THE NET DOMESTIC ASSETS OF THE CENTRAL BANK; 2) LIMITS ON NET DOMESTIC CREDIT OF THE PERUVIAN BANKING SYSTEM TO THE PUBLIC SECTOR; 3) TARGETS FOR THE NEW INTERNATIONAL RESERVE POSITION OF THE CENTRAL BANK; 4) LIMITS ON THE CONTRACTING OF NEW CREDITS BY THE PUBLIC SECTOR. THE IMF IS ASSUMING THAT PERU WILL RECEIVE DEBT RELIEF IN 1979 AND FOR THE REST OF 1978, BUT THE SPECIFIC PERFORMANCE CRITERIA ARE FLEXIBLY STATED TO ACCOMMODATE THE CONTINGENCY OF NO OR LITTLE DEBT RELIEF. FOR EXAMPLE, THE PROGRAM CALLS FOR A 50-60 BILLION SOLE LIMIT ON THE FISCAL DEFICIT FOR 1978, WHICH TAKES INTO ACCOUNT THE NOW-SUSPENDED DOLS. 185 MILLION IN REPAYMENTS TO COMMERCIAL BANKS EXPECTED TO BE ROLLED OVER AFTER JANUARY 3, 1979. SHOULD THOSE CREDITS NOT BE ROLLED OVER, THE CEILING ON DOMESTIC FINANCING REQUIREMENTS RISES TO ABOUT 80 BILLION SOLES.

FOR 1979, THE PUBLIC SECTOR DEFICIT IS SCHEDULED TO BE 87 BILLION SOLES; THE CEILING ON NET DOMESTIC FINANCING IS 80 BILLION SOLES, LEAVING 7 BILLION TO BE FINANCED EXTERNALLY. WITH DEBT RELIEF IN 1979, THE FUND WOULD ADJUST DOWNWARD THE CEILING ON NET DOMESTIC FINANCING. THE IMF HOPES FOR DEBT RELIEF IN THE MAGNITUDE OF AROUND DOLS. 480 MILLION, WHICH WOULD BRING

THE CEILING TO ZERO. THIS EXPECTED SPECIAL BALANCE-OF-PAYMENTS RELIEF WOULD BE COMPRISED OF DOLS. 30 MILLION IN SOVIET DEBT WHICH HAS ALREADY BEEN ROLLED OVER, DOLS. 185 MILLION IN NEW COMMERCIAL BANK FINANCING TO COVER PART OF THE DOLS. 390 MILLION DUE THE BANKS IN 1979, THE HOPED-FOR DOLS. 100 MILLION IBRD PROGRAM LOAN, AND ABOUT DOLS. 165 MILLION FROM OFFICIAL DEBT RESCHEDULING. THE WORLD BANK PROGRAM LOAN WOULD BE DISBURSED IN TWO TRANCHES IN 1979, SUBJECT TO SUB-CONFIDENTIAL

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STANTIAL COMPLIANCE WITH THE IMF PROGRAM (COMMENT: BANK STAFF INSISTS THE PROGRAM LOAN IS STILL IN INITIAL STAGE OF DISCUSSION, AND THE SCHEDULE FOR DRAWINGS UNDETERMINED. END COMMENT). ALL OF THIS AFOREMENTIONED DEBT RELIEF WOULD GO ABOVE THE LINE IN THE BALANCE OF PAYMENTS. BELOW THE LINE PERU WOULD RECEIVE 80 MILLION SDR'S IN 1979 OR DOLS. 97 MILLION AS IT WILL IN 1980. ALSO BELOW THE LINE, PERU WILL RECEIVE DOLS. 73 MILLION IN THE NEXT FEW MONTHS FROM THE COMPENSATORY FINANCING FACILITY. HOWEVER, MANY OF THESE IMF CREDITS WOULD GO TO REPAY DOLS. 90 MILLION DUE THE FUND OVER THE NEXT TWO YEARS. IMF CREDITS REMAINING COULD BE USED TO REPAY SHORT-TERM SWAPS OBTAINED BY PERU FROM OTHER CENTRAL BANKS AND PERHAPS BE USED TO IMPROVE NET RESERVES. THE BALANCE OF PAYMENTS RELATED PERFORMANCE CRITERIA IN THE FUND AGREEMENT INDICATE A DOLS. 173 MILLION DECREASE IN NET INTERNATIONAL RESERVES, AND A CURRENT ACCOUNT DEFICIT OF DOLS. 500 MILLION IN 1978. THESE FIGURES ASSUME THAT THE DOLS. 185 MILLION IN COMMERCIAL BANK MATURITIES WHICH ARE NOW SUSPENDED WILL BE ROLLED OVER.

4. IN 1979, DUE LARGELY TO AN INCREASE IN OIL PRODUCTION AND REDUCED MILITARY IMPORTS, THE CURRENT ACCOUNT BALANCE SHOULD BE A NEGATIVE DOLS. 100 MILLION AND NET INTERNATIONAL RESERVES ARE DUE TO INCREASE BY DOLS. 145 MILLION. HOWEVER, IN THE ABSENCE OF ANY DEBT RELIEF, THE FUND AGREEMENT WOULD ALLOW FOR AN ADJUSTMENT OF THE NET RESERVE TARGET TO A CEILING OF A NEGATIVE DOLS. 305 MILLION CHANGE. CONFIRMING EMBASSY REPORTS, THERE ARE NO PERFORMANCE CRITERIA RELATIVE TO THE EXCHANGE RATE. THE FUND STAFF FEEL THAT THE CURRENT EXCHANGE RATE OF 164 SOLES TO THE DOLLAR IS QUITE CONFIDENTIAL

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CLOSE TO EQUILIBRIUM, AND VERY CLOSE TO CONVERGING WITH THE PARALLEL CD MARKET RATE OF 175 SOLES TO THE DOLLAR. FROM NOW ON THE GOVERNMENT OF PERU HAS AGREED TO DEPRECIATE THE SOLE DAILY IN ACCORDANCE WITH INFLATION,

AIMING FOR A TARGET OF JUST UNDER 200 SOLES TO THE DOLLAR BY YEAR-END. INFLATION HAS BEEN RUNNING ABOUT 100 PERCENT ON AN ANNUAL BASIS IN THE FIRST SEMESTER OF 1978 REFLECTING THE COST PUSH FACTORS OF THE AUSTERITY MEASURES ALREADY TAKEN EARLIER IN THE YEAR, SUCH AS THE EXCHANGE RATE DEPRECIATION AND ELIMINATION OF SUBSIDIES ON CONSUMER GOODS. MOST OF THOSE COST PUSH FACTORS ARE NOW BEHIND PERU, SO IT IS HOPED THAT THE INFLATION RATE WILL BEGIN TO TAIL OFF ON THE LAST SEMESTER OF THIS YEAR, WITH AVERAGE INFLATION FOR 1978 BEING IN THE LOW 80'S. THE FUND HOPES THAT INFLATION WILL BE BROUGHT DOWN TO THE 40-50 PERCENT RANGE IN 1979.

5. KEY TO RAISING DOMESTIC SAVINGS AND HALTING VERY SUBSTANTIAL CAPITAL FLIGHT IS THE INTEREST RATE POLICY CONTAINED IN THE PROGRAM. ALTHOUGH INTEREST RATES WERE RECENTLY RAISED TO OVER 30 PERCENT ON DEPOSITS, THIS IS STILL FAR BELOW THE LEVEL NEEDED TO ACHIEVE POSITIVE REAL INTEREST RATES. PERU'S ECONOMIC TEAM IS IN A RATHER DIFFICULT POSITION VIS-A-VIS INTEREST RATE POLICY, FOR IT RELIES FOR ITS SUPPORT ON THE PRIVATE BUSINESS COMMUNITY WHICH REPORTEDLY IS STRONGLY OPPOSED TO FURTHER INCREASES IN THE INTEREST RATE. RECOGNIZING THIS PROBLEM THE FUND HAS ASKED FOR AN INCREASE IN RATES ONLY TO 50 PERCENT AND WOULD SETTLE FOR PERHAPS 45 PERCENT WHICH WOULD STILL BE IN THE RANGE OF NEGATIVE REAL RATES. ALTHOUGH CREDIT CEILINGS ARE HIGHLY CONTRACTIVE, THEY INDICATE A RELATIVE EASING OF CREDIT TO THE PRIVATE SECTOR. COMMERCIAL BANK RESERVE REQUIREMENTS ARE TO BE UNIFIED AT 40 PERCENT.

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6. A SPECIAL PERFORMANCE CRITERION IN THE FUND AGREEMENT RELATES TO EXCHANGE CONTROLS. HENCEFORTH, ALL SUCH CONTROLS MUST HAVE FUND APPROVAL. THIS REQUIREMENT WAS WRITTEN IN THE AGREEMENT AS A DEVICE TO INSURE THAT APPROXIMATELY DOLS. 100 MILLION IN ARREARS ACCUMULATED THIS YEAR, MUCH OF WHICH ACCRUED WHEN FOREIGN BANKS INVOLUNTARILY COVERED LETTERS OF CREDIT, WOULD BE REPAID. IT IS HOPED THAT THESE ARREARS WILL BE ELIMINATED BY THE END OF THIS YEAR, BUT THE FUND IS PREPARED TO SEE SOME OF THEM REMAIN UNTIL JULY, 1979 WHEN THERE WILL BE A SCHEDULED PERFORMANCE REVIEW. OF SOME CONCERN TO THE FUND'S STAFF IS THE DELAY IN FORMALLY REQUESTING A

PARIS CLUB-TYPE DEBT RESCHEDULING. THE MINISTRY OF FOREIGN AFFAIRS HAS RESPONSIBILITY FOR REQUESTING SUCH DEBT RELIEF AND APPARENTLY HAS BEEN DRAGGING ITS FEET. OFFICIAL DEBT RESCHEDULING IS LIKELY TO BE REQUIRED BY THE WORLD BANK BEFORE IT WILL GRANT ITS DOLS. 100 MILLION PROGRAM LOAN, AND OF COURSE, WOULD SERVE AS

FURTHER ENCOURAGEMENT FOR THE PRIVATE BANKS TO GRANT A BALANCE-OF-PAYMENTS LOAN IN 1979. IT IS FELT THAT AN AGREEMENT MUST BE REACHED WITH OFFICIAL CREDITORS IN THE LAST QUARTER OF THIS YEAR. GIVEN THE LEAD TIME NECESSARY FOR PERU TO GATHER ITS DATA, MAKE ITS PRESENTATION TO CREDITORS, AND THEN HAVE CREDITORS EVALUATE THAT INFORMATION, PERU SHOULD SELECT A HOST COUNTRY AND FORMALLY REQUEST A CONVENING OF A CREDITORS CLUB AS QUICKLY AS POSSIBLE. THE FUND HAD HEARD RUMORS AT VARIOUS TIMES RECENTLY THAT THE PERUVIANS HAVE CONSIDERED ASKING THE ITALIANS, THE DUTCH, AND THE U.S. TO HOST A RESCHEDULING, AND THAT 6 TO 8 WEEKS AGO THE FRENCH WERE APPROACHED AT A LOW DIPLOMATIC LEVEL.

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7. COMMENT: TALKS WITH WORLD BANK STAFF INDICATE THAT THE GOP MAY BE DELAYING A REQUEST FOR OFFICIAL DEBT RESCHEDULING UNTIL THEY HAVE SUFFICIENTLY STUDIED THEIR DATA TO DETERMINE THE MINIMUM AMOUNT OF OFFICIAL DEBT WHICH MUST BE RESCHEDULED TO PROVIDE NEEDED RELIEF. MOREYRA REPORTEDLY TOLD BANK OFFICIALS THAT PERU WISHES TO REPAY AS MUCH AS POSSIBLE OF ALL PRIVATE AND OFFICIAL DEBT FALLING DUE IN 1979 SO AS TO AVOID SIMPLY POSTPONING A FINANCIAL CRISIS TO LATER YEARS. THE DEPARTMENT WOULD APPRECIATE ANY INFORMATION YOU MAY GATHER AS TO GOP INTENTIONS REGARDING OFFICIAL DEBT RESCHEDULING. END COMMENT. VANCE

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